April 6, 2009

Mary Rupp, Secretary of the Board,
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Subject: Comments on Advanced Notice of Proposed Rulemaking for Part 704

Dear Ms. Rupp:

Eastman Credit Union appreciates the opportunity to comment on proposed revisions to Part 704 of NCUA's Rules and Regulations. We consider corporate credit unions a critical vendor for our daily operations and feel they should retain a role in the credit union system. In addition, we agree that regulation governing corporate credit unions is in need of revision and provide comments on the following: role of "corporates" in the credit union system, corporate capital, permissible investments, credit risk management, asset liability management, and corporate governance.

<u>Role of "Corporates" in the Credit Union System</u>
"Corporates" provide a number of services to natural person credit unions such as payment systems, liquidity management options, and investment services. A majority of all credit unions rely on their "corporates" to provide these services at competitive prices. "Corporates" have been able to offer such services at competitive prices due to the earnings generated from their entire product line.

Payment systems
A charter that restricts corporate operations to a single product line (i.e. payment systems) with no authority to engage in other services does not provide any apparent benefit. In our opinion such a restrictive charter would create additional overhead and inefficiencies within the corporate network. Given the critical nature of a reliable payment system, consideration should be given to creating a legal and operational firewall between payment systems and other "corporate" services.

Liquidity and liquidity management
Meeting the liquidity needs of member credit unions is another vital "corporate" service. Almost all natural person credit unions have lines of credit established at "corporates", primarily for short-term funding needs. While "corporates" provide this service very economically, many other options exist such as the Federal Reserve, the FHLB system, or even other natural person credit unions. Regulatory change could enable the Central Liquidity Fund to be accessed by natural person credit unions and "corporates" in a more efficient manner. Limiting corporate credit unions ability to offer other services in order to preserve and defend the liquidity function would not be a prudent business decision. Again, in order to remain competitive, corporate operations must be able to generate sufficient earnings.

Field of membership issues
A number of "corporates" have been granted a national field of membership (FOM). National FOMs enable "corporates" to diversify their membership and mitigate risk associated with single state or regional FOM limitations. A consideration might be an annual review to determine how effective "corporates" are utilizing their national FOMs.

Furthermore, natural person credit unions and their members benefit from competition among corporate credit unions; as well as, competition among “corporates” and other financial service providers. A natural process of consolidation will probably occur within the corporate network as increased competition dictates an increase in efficiency.

Expanded investment authority
Regulatory options for expanded investment authority should be preserved; however, investment staff knowledge, capital requirements, and regulatory oversight must be commensurate with risk. In addition, annual independent reviews should occur as part of a requalification process for expanded authority.

Structure; two-tiered system
The current two-tiered corporate system is inefficient and does not currently provide sufficient ability for natural person credit unions to diversify holdings within the corporate network. Almost all retail “corporates” rely on services provided by US Central FCU and have significant holdings in US Central FCU making the entire credit union industry highly susceptible to concentration risk. As an example, US Central FCU was a primary source of liquidity for the corporate network, the current market dislocation and resulting liquidity crisis has caused US Central FCU to struggle with meeting the liquidity needs of its retail corporate members and forced them to seek alternative liquidity sources. In addition, consolidation within in the industry has left only 27 active retail “corporates”. As the number of retail “corporates” continues declines, the need for a wholesale corporate becomes more questionable.

Corporate Capital
Regulatory reform regarding the corporate capital structure must be a priority. Inadequate capital requirements for US Central FCU and retail “corporates” (especially those with expanded authority) have forced the entire credit union industry into an extremely challenging environment to say the least.

Retained earnings should be the cornerstone benchmark for capital. “Corporates” should not be limited to the services offered but capital levels should be sufficient for the risk inherent within their balance sheet. Corporate risks are no less than those of natural person credit unions and arguably greater. Capital requirements imposed on “corporates” must be risk based.

Core Capital
Under current regulation, a “corporate’s” core capital is defined as retained earnings plus paid-in capital. Inclusion of paid-in capital into core capital would be acceptable; however, natural person credit unions should not be required to contribute paid-in-capital to “corporates”. Natural person credit unions contributing paid-in-capital must understand the associated risks and should receive benefit for taking on the risk. In addition, the financial condition of the natural person credit union must be sufficient to absorb the loss of paid-in-capital if incurred. Restricting corporate services to only those natural person credit unions that contribute paid-in-capital could drive existing members from “corporates”.

Again, minimum capital standards must be risk weighted. It seems to make sense to begin evaluating corporate capital requirements and the timeframe for achieving established requirements with standards already applied by other federal financial regulators. Allowances will probably be necessary given the unique characteristics of "corporates".

Membership Capital
Natural person credit unions should not be required to contribute capital in order to obtain service from "corporates". Those wishing to contribute capital to "corporates" and willing to accept associated risk should benefit in some manner either through dividends paid on the capital account or by receiving higher dividends on other corporate accounts or by reduced fees for services utilized.

Risk-based capital and contributed capital requirements
As previously mentioned risk-based capital requirements must be included in regulatory reform for "corporates". NCUA should consider risk-based capital requirements of other federally regulated financial institutions but be willing to be flexible in applying those standards to "corporates" given their unique characteristics. Also, as previously mentioned, we do not believe natural person credit unions should be required to contribute capital to "corporates" as a prerequisite to obtaining service from "corporates".

<u>Permissible Investments</u>
"Corporates" have the ability to purchase and hold investments that are not permissible for natural person credit unions. Natural person credit unions have an obligation to know the composition and risk of their affiliate corporate investment portfolios. Likewise, "corporates" have an obligation to provide clear and concise information regarding their investment portfolio composition, performance, and risk. One consideration is a requirement for an annual 3rd party review and subsequent report of findings to the membership if the portfolio composition warrants.

Further restriction of investment options is not necessary in the event corporate capital requirements are adequately adjusted for inherent risk and if adequate transparency exists. In addition, regulatory expertise, corporate staff expertise, and organizational structure must be sufficient to support the level of inherent risk.

Requirements for sector diversification do seem to make sense. One factor in the current corporate crisis is the appearance of a heavy concentration in mortgage-backed and asset-backed securities in corporate investment portfolios. In addition, the regulator must be more aware of systemic risks within the corporate network (i.e. total corporate sector concentrations).

<u>Credit Risk Management</u>
Credibility and reliability of the rating agencies is certainly in question. Many individuals, companies, and countries have suffered financial loss as a result of reliance on the rating agencies. A requirement for multiple ratings on an investment cannot hurt, but ultimately sufficient corporate due diligence must be required prior to purchasing a security. In addition, regulatory reform should include additional stress modeling tools to enhance credit risk management; as well as, requirements for ongoing monitoring and independent evaluations. Independent evaluations must be performed by qualified individuals and should be available to natural person credit unions for review.

Asset Liability Management
Given the nature of the corporate business, an effective ALM process is essential. In fact all risks must be managed and not simply avoided. The sophistication of a “corporate’s” ALM process must be commensurate with inherent risk. Requirements for mandatory modeling and testing are important but cannot be written as a one size fits all. A balance must be struck between safety/soundness and the ability to function competitively.

Corporate Governance
Corporate credit unions have become increasingly more complex; as a result required management skills have escalated. Minimum standards for directors in regard to their level of experience and independence are necessary. The talent pool for corporate directors should not exclude “outside directors” (i.e. those who are not officers of the corporate, officers of member natural person credit unions, and/or individuals from entirely outside the credit union industry). If US Central FCU continues to exist, it should be required to have 50% of its directors from natural person credit unions. Term limits for corporate directors should be considered; for example, a staggered 3 term limit would provide for some consistency on the board as new board members are added. In addition, compensation for all corporate directors should be considered as a means of attracting the most qualified individuals.

Sincerely,

David Atkinson, Executive Vice President & CFO
Eastman Credit Union